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IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

BEN POLIKOFF, *Petitioner,*

vs.

MAURICE S. LEVY, LOUIS C. RAPPAPORT, HARRY MILLER AND SIDNEY MILLER, *Respondents.*

PETITION FOR A WRIT OF CERTIORARI TO THE APPELLATE COURT OF ILLINOIS, FIRST DISTRICT

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No. ....

BEN POLIKOFF, *Petitioner*,

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MAURICE S. LEVY, LOUIS C. RAPPAPORT, HARRY MILLER AND SIDNEY MILLER, *Respondents*.

PETITION FOR A WRIT OF CERTIORARI TO THE APPELLATE COURT OF ILLINOIS, FIRST DISTRICT

Petitioner, Ben Polikoff, prays that a writ of certiorari issue to review the judgment of the Appellate Court of Illinois, First District, entered in the above-entitled case on January 25, 1965, which judgment the Supreme Court of Illinois, on May 18, 1965, declined to review.

THE OPINION BELOW

The opinion of the Appellate Court of Illinois is reported at 55 Ill. App. 2d 229 and 204 N.E. 2d 807. The opinion is printed in Appendix A hereto, *infra*, pp. 1a-7a.

JURISDICTION

The judgment of the Appellate Court of Illinois was entered on January 25, 1965 (Appendix B hereto, *infra*,

p. 8a). The Appellate Court denied petitioner's petition for rehearing by order entered March 1, 1965 (record of proceedings in Appellate Court of Illinois, pp. 16-17). By orders entered on May 18, 1965, the Supreme Court of Illinois dismissed petitioner's notice of appeal and denied his petition for leave to appeal (record of proceedings in Illinois Supreme Court, pp. 22-23). The jurisdiction of this Court is invoked under Title 28 U.S.C., Section 1257(3), since a right is claimed under the statutes of the United States.

QUESTIONS PRESENTED

1. Whether units of investment in a motel enterprise, evidenced initially by "tentative receipts" and ultimately by shares of corporate stock, which are offered or sold to at least 40 persons by promoters who plan the enterprise, purchase the real estate, retain the architects and arrange for mortgage financing, are securities within the meaning of Section 2(1) of the Securities Act of 1933?

2. Whether an interest in an enterprise deemed to be a joint venture under state law may nevertheless be a security within the meaning of Section 2(1) of the Securities Act, or whether as a matter of law (as the court below held) such interest cannot be a security because the holder thereof has a theoretical right under state law to participate in the management of the enterprise and therefore could not have been "led to expect profits solely from the efforts of the promoter or a third party" within the definition of "investment contract" enunciated in this Court's decision in *Securities and Exchange Commission* v. *W. J. Howey Co.*, 328 U.S. 293 (1946).

STATUTES INVOLVED

The Securities Act of 1933, as amended, Section 2(1) [48 Stat. 905, 15 U.S.C. Sec. 77b(1)]:

"When used in this title, unless the context otherwise requires—

"(1) The term 'security' means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a 'security,' or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing."

The Securities Act of 1933, as amended, Sections 5(a) and (c) [68 Stat. 684, 15 U.S.C. Sec. 77e (a) and (c)]:

"(a) Unless a registration is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

"(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

"(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale."

"(c) It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order

or (prior to the effective date of the registration statement) any public proceeding or examination under section 8 [Sec. 77h of Title 15, U.S.C.]."

The Securities Act of 1933, as amended, Section 12(1) [68 Stat. 686, 15 U.S.C. Sec. 77l(1)]:

"Any person who—

"(1) offers or sells a security in violation of section 5 [Sec. 77e of Title 15, U.S.C.], or

"(2) . . . ,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security."

STATEMENT OF THE CASE

Count IV of the amended complaint (set forth in Appendix C hereto, *infra*, p. 9a *et seq.*) alleges a violation of the Securities Act of 1933 as a result of the offering by the promoters of a motel enterprise (the respondents herein) of unregistered, non-exempt "units" in the enterprise that were evidenced initially by "tentative receipts" and ultimately by shares of corporate stock. Respondents' motions to dismiss count IV on the ground that "the transaction in question was a joint venture in the purchase of real estate and the construction of a motel on the said real estate, and a joint venture is not . . . within the Federal Securities Act of 1933" (Abstract of Record*, pp. 26-29) were granted by the Circuit Court of Cook County, Illinois (Abstract of Rec-

* The abstract of record appears at p. 3 of the record of proceedings in the Appellate Court of Illinois.

ord, pp. 44, 51-52).* In affirming the dismissal of count IV, the Appellate Court of Illinois held that the enterprise was a joint venture under state law and that therefore the units were not securities because it is "quite clear" that a joint venture "is not within the provisions" of the Securities Act (p. 7a, *infra*) and that petitioner, as a joint venturer, "did not pay his money with the expectation that future profits from the venture would come *solely from the efforts of others*" (p. 6a, *infra*). (See subheading "The Appellate Court Opinion," *infra*, p. 7.)

The Facts

According to the allegations of the amended complaint**, petitioner received a letter (set forth at pp. 9a-10a, *infra*) from respondent Levy soliciting his investment in a motel enterprise. In the letter Levy stated that a "group" of persons had "purchased a parcel of real estate . . . and are contemplating building a Super DeLuxe Motel. . . ." The letter also stated, "We are selling units of $10,000.00 each and we still have available for investment about 15 units or $150,000.00." The letter advised that the group had selected the architects and had arranged the mortgage financing. Enclosed with the letter was a statement containing a "Computation of Capital Requirements" and a "Projected

* Count IV raises the Securities Act issue and is the only count involved in this petition. Count III, which was also dismissed by the court below, was based on the Illinois Securities Law of 1953. Counts I and II seek the rescission of petitioner's investment on the common law ground of money had and received and are still pending. When the Circuit Court of Cook County dismissed counts III and IV, it expressly found that there was no just reason for delaying appeal thereon (Abstract of Record, p. 52). Such finding renders the judgment in respect of counts III and IV final and appealable under Illinois law. Ill. Rev. Stat., 1963, ch. 110, Sec. 50(2).

** Since count IV of the amended complaint was dismissed on motion, the allegations of that count are deemed to be admitted and are taken as true for the purposes hereof. See, *e.g.*, *People* v. *Standard*, 9 Ill. 2d 372, 376, 137 N.E. 2d 829, 831 (1956).

Annual Cash Flow Based on Estimated 72% Occupancy" (pp. 10a-12a, *infra*). The "computation" set forth the cost of the land, building and furnishings, the architectural and engineering fees, the interim financing, mortgage and title costs, taxes, insurance and legal and other sundry expenses, the amount of working cash required, the proceeds of a real estate mortgage and a furnishings contract, and, based on such costs and financing proceeds, indicated that the total capital required by the enterprise was $665,000 (p. 10a, *infra*). In the "cash flow" projection the promoters set forth (pp. 11a-12a, *infra*) a detailed listing of the enterprise's projected receipts, payroll disbursements, operating expenses and debt service charges, and they projected a "cash throw-off" of $130,000 per year (being approximately 19% of the amount of the total capital shown to be required in the computation).

After receipt of the letter, petitioner informed respondent Levy that "he would be willing to make an investment of $50,000" (p. 13a, *infra*). Thereafter, upon Levy's further request, petitioner sent Levy $25,000 each on two separate occasions and received in the mails in respect of each payment a letter "in the form of a tentative receipt" pending the preparation and delivery to petitioner of the "actual agreements and other documents" and acknowledging that petitioner's payments were "for the purpose of acquiring an interest in the contemplated building at the above motel" (pp. 13a-15a, *infra*). Later, in response to another request from Levy, petitioner paid an additional $7,500 and received a third tentative receipt (pp. 15a-16a, *infra*).

Following the solicitation of petitioner's investment, respondents continued to offer to sell to other persons the "units" of investment in the motel. As the result of such offers, both prior to and subsequent to the solicitation of

petitioner's investment, respondents were given approximately $500,000 by at least 40 persons (p. 13a, *infra*).

Respondents subsequently caused a corporation named The State House Inn Corp. to be organized, and they offered some of its stock to petitioner for all rights and interests which petitioner had by virtue of his investment of $57,500 (p. 17a, *infra*). Petitioner refused to accept the stock and demanded the return of his $57,500, but respondents nevertheless purported to transfer to the corporation all of petitioner's rights and interests in the payments he had made (pp. 17a-18a, *infra*). Upon respondents' refusal to return the money, petitioner commenced this action.

The amended complaint also alleged that the units of investment and the stock in the corporation were securities under the Securities Act (p. 18a, *infra*); that they were not exempt securities (p. 18a, *infra*); that the transactions alleged in the complaint were not exempt transactions (p. 18a, *infra*); that no registration statement had ever been filed with respect to the units or the stock (p. 19a, *infra*); and that therefore petitioner was entitled to recover his investment under the provisions of the Securities Act (p. 20a, *infra*).

The Appellate Court Opinion

In the Appellate Court the respondents contended that petitioner had entered into a joint venture and that the transaction was therefore not subject to the Securities Act (p. 3a, *infra*). The Appellate Court treated the sole question before it as being "whether the 'units' of interest in the motel venture are securities as defined by the state and federal acts" (p. 3a, *infra*). In holding that the "units" were not securities, the Appellate Court stated:

> "Both the Illinois and the federal courts have emphasized that a security within the meaning of the acts is a contract, transaction or scheme whereby one person

invests his money in a common enterprise on the theory that he expects to receive profits *solely from the efforts of others.** . . . [p. 4a, *infra.*]

"We believe that neither the Illinois Blue Sky Act nor the Federal Securities Act apply in the instant case. Here we have a joint venture to buy and improve real estate by a group which included the plaintiff and the defendants. . . . [p. 5a, *infra.*]

". . . .

"In both partnerships and in joint ventures members of the group have equal rights of management and control of the enterprise. [Citation omitted.] Hence when the plaintiff paid his money into the motel project as a member of a joint venture, he acquired equal rights of control of the activities of the venture. Therefore we believe that he did not pay his money with the expectation that future profits from the venture would come *solely from the efforts of others.* Hence the transactions involved here do not fall within the scope of the Illinois or federal securities acts." [Emphasis by the court below; p. 6a, *infra.*]

REASONS FOR GRANTING THE WRIT

1. The Court Below Interpreted This Court's Howey Decision in Such a Manner as to Produce a Serious Conflict with the Purposes of the Securities Act of 1933.

In *Securities and Exchange Commission* v. *W. J. Howey Co.*, 328 U.S. 293, 298-9 (1946), this Court held that "an investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party."

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* The only federal court cases which the court cited were *Howey* and *Securities and Exchange Commission* v. *Bailey*, 41 F. Supp. 647 (S.D. Fla., 1941).

The court below gave overriding significance to the "solely" portion of this quotation. It said, citing *Howey*, that "the federal courts have emphasized that a security within the meaning of the acts is a contract, transaction or scheme whereby one person invests his money in a common enterprise on the theory that he expects to receive profits *solely from the efforts of others.*" (Emphasis by the court below; p. 4a, *infra*.) It stated that the reason for excluding from the securities laws transactions in which profits do not come solely from the efforts of others "is clear," and that the reason was that "in such situations" the investor has equal right of control and opportunity for knowledge with others in the group and that therefore the disclosure protection of the Securities Act is not needed (p. 4a, *infra*). It concluded that in the instant case the allegations of the complaint met these tests for non-application of the Securities Act because they showed a "community of interest among the plaintiff and defendants to erect and operate a motel" and also presented an "expectation of profit and the sharing thereof among the members of the group" (p. 5a, *infra*). This, the court held, showed that the enterprise was a "joint venture to buy and improve real estate by a group which included the plaintiff and the defendants" (p. 5a, *infra*), and that since joint ventures involve equal rights of management and control, petitioner did not pay his money "with the expectation that future profits from the venture would come *solely from the efforts of others*" (emphasis by the court below; p. 6a, *infra*).

It is clear that under state substantive law joint venturers have equal rights of management and control. *Lindley* v. *Murphy*, 387 Ill. 506, 56 N.E. 2d 832 (1944). But it is equally clear that merely denominating an enterprise a joint venture does not necessarily produce the factual result of equality of management and control. There are no allega-

tions in count IV respecting management or control, but there are allegations that at least 40 persons became purchasers and the court below itself noted that "the members of the group were not specifically identified for the plaintiff and the size of the group was not fixed at the time the plaintiff joined" (p. 6a, *infra*). Plainly 40 or more purchasers, not even known to each other, could not share equally in developing and managing the motel; nor was there any expectation that they would do so, as evidenced by the ultimate effort to employ the corporate form of organization. If an enterprise of this kind may be cast in the form of a joint venture, with resulting theoretical but not actual sharing of management by the investors, and if the theoretical sharing of management is then deemed inconsistent with the "solely from the efforts of the promoter or a third party" concept of *Howey*, then a large hole will have been torn in the fabric of the Securities Act protection.

Since the decision in the *Howey* case, over 19 years ago, this Court has never had occasion to discuss the significance and precise meaning of the phrase "solely from the efforts of the promoter or a third party" in its definition of "investment contract" as a form of security.* Although this Court, in *Howey*, stated that the definition of security in the Securities Act "embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of money of others on the promise of profits" (328 U.S., at 299), the court below relied on the "solely" phrase to restrict the reach of the Securities Act.** Thus, the *Howey* decision, which was intended by this Court to bolster the "statutory policy of affording broad protection

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* Although the *Howey* language has been quoted or cited in a number of lower Federal court decisions, none which we have found has dealt directly and explicitly with the meaning of the "solely" phrase.

** In this respect it should be noted that, although the "solely" clause in *Howey* was used only in defining an "investment contract," the court below applied it to any type of "security."

to investors" (328 U.S., at 301), may now provide a loophole in the guise of the "solely" requirement.

Using this loophole, promoters will be free from Securities Act registration if they cast the enterprise in the form of joint venture or in some other legal form involving, under state law, a theoretical right of management and control (or even an insubstantial amount of actual control) by the investor. A transaction could be insulated even if the enterprise were in corporate form, so long as the corporation were (as in the instant case) an outgrowth of the joint venture.

Moreover, the decision below is in conflict with recent positions taken by the Securities and Exchange Commission to the effect that an interest in a joint venture may be a security under the Securities Act. Thus, in its Rule 3a11-1, adopted on April 23, 1965, under the Securities Exchange Act of 1934 (which has a definition of "security" substantially similar to that contained in the Securities Act*), the Commission defined "equity security" as including "any . . . interest in a joint venture" (17 C.F.R. §240.3a11-1).** A regional administrator of the Commission, speaking of real estate syndication, made a similar point when he said:

> "Whether they [real estate syndicates] take a form of a Massachusetts or other type of trust, a limited or a

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* Securities Exchange Act of 1934, as amended, Section 3(a)(10), [48 Stat. 882, 15 U.S.C., Sec. 78c(a)(10)].

** In its Securities Act Release No. 4347 (April 10, 1961), the Commission proposed that Form S-11 be used for the registration of certain real estate investment trusts and by "real estate syndicates, partnerships, *joint venturers* or other incorporated or unincorporated issuers" whose business is primarily that of acquiring and holding real estate or interests in real estate for investment (26 F.R. 3280, F.R. Doc. 61-3425; emphasis supplied). In the final draft of Form S-11, the more general words "other issuers" were substituted for the words quoted in the preceding sentence (17 C.F.R. §239.18).

general partnership, a joint venture, a fractionalized title or mortgage, or anything else that the ingenuity of the lawyer or the promoter may devise, it is required by the Securities Act of 1933 that the interests which are sold or even offered for the purpose of raising money be registered." (Remarks of Paul Windels, Jr., SEC Regional Administrator, to the Association of Real Estate Syndicators, Inc., February 6, 1958, New York City, as quoted in Berger, *Real Estate Syndication: Property, Promotion, and the Need for Protection*, 69 Yale L.J. 725, at 764, n.166 (1960).)

The decision of the court below interprets *Howey* in a rigidly conceptualistic manner and creates a type of investment—a joint venture interest—which is said as a matter of law not to be a security within the meaning of the Securities Act. This conclusion is in conflict not only with these recent positions of the Commission but also with the spirit and purpose of the Act. In light of this fundamental misuse of the teaching of *Howey*, and particularly in light of the lapse of 19 years without significant discussion of the "solely" phrase, it is important that this Court grant the writ of certiorari in order to make it clear that *Howey* is not to be misread as a controlling authority which precludes an investment from being a security under the Act if a theoretical or insubstantial power of management or control is conferred, or if under state law the theoretical right to such power exists.

2. The Uncertainty Produced by the Decision Below May, If Not Remedied, Have Special Impact with Respect to Real Estate Syndication, an Activity as to Which the Applicability of the Securities Act of 1933 Has Not Been Considered by the Courts.

Since the *Howey* decision there has been a significant development in the marketing of interests in real estate. "[T]he spectacular expansion since approximately 1950 of public participation in real estate equities justifies its de-

scription as a new phenomenon in the securities markets. . . ." *(Report of Special Study of Securities Markets of the Securities and Exchange Commission,* 88th Cong. House Doc. 95, Part 1, pp. 575-6.) The Commission's Special Study noted that in 1961 and 1962, offerings of such equities in New York State, the center of this activity, aggregated $1.8 billion (*id.*, at p. 576). It stated that unofficial estimates of such sales "run even above $10 billion" *(ibid.)*. Commentators likewise have noted the substantial surge in the amount of syndicated offerings. See, *e.g.*, Berger, *Real Estate Syndication: Property, Promotion, and the Need for Protection,* 69 Yale L.J. 725 (1960).

Syndication has been defined as "the pooling of resources of a group of individual investors to acquire or develop an agreed-upon real asset" (Berger, at pp. 725-7). The process of syndication is described in the Special Study:

> "The syndicator first finds the property which he intends to syndicate . . . and enters into a purchase contract with the owners. . . . Then, to acquire title to the syndicate property, the syndicator organizes a business entity, the securities of which will be offered to the public." [Special Study, pp. 577-578.]

The entity itself may take any one of a variety of forms (Berger, *op. cit.*, pp. 729-30), and involve various types of properties (*id.*, at p. 726). The offering of interests in it may likewise be made in a variety of ways, limited, as the Special Study said, "only by the ingenuity of the syndicators" (p. 578).

The instant case, of course, involves an enterprise properly described as a "syndication." Here the promoters, having selected and acquired real property and made arrangements for developing it, pooled the resources of a group of investors (by offering for sale units of interest in their enterprise) for the purpose of paying for the acquired real estate and developing it.

In "the early days" there was a "great deal of uncertainty as to whether or not an interest in a syndicate was a security." Wein, *The Why and How of Real Estate Syndications, How the Syndicate Functions,* 5 The Practical Lawyer 54, 56 (March, 1959). As illustrated by the decision below, this uncertainty has never been eliminated by a definitive decision dealing with the application of the Securities Act to syndicate promotions. "[T]he federal courts have not had occasion to consider the typical real estate syndicate . . ." Kroll, *The Why and How of Real Estate Syndications, Regulation Aspects,* 5 The Practical Lawyer 70, 71 (March, 1959); also see Berger, *op. cit. supra,* at 763. Nor, possibly as a consequence, have many syndications registered their offerings under the Act. "Of the 201 limited-partnership real estate syndicates evidenced by certificates filed during 1958 and 1959 in The New York County Clerk's Office, only 8 followed the SEC channels." Berger, *op. cit. supra,* at 760.

Many syndications may, of course, go unregistered because of the availability of exemptions under the Securities Act. Many may also go unregistered, however, because the absence of a clear-cut Federal decision on the applicability of the Act to syndicate offerings permits promoters to resolve uncertainties, real or fancied, in favor of non-compliance with the Act. The decision below, by the appellate court of a large commercial state, cannot but encourage avoidance of the Act in respect of syndicate offerings. Given the increased importance of real estate syndication, it would be highly desirable for this Court to grant the writ of certiorari in order to state definitively that the Securities Act does apply to this significant form of investment.

CONCLUSION

The petition should be granted,

(1) to insure that this Court's *Howey* decision, a leading authority with respect to the application of the Securities Act of 1933, not be distorted by lower courts into a precedent which restricts the application of this Act in a manner contrary to its purpose and philosophy, and

(2) to answer definitively the question of the applicability of the Securities Act of 1933 to the important field of syndication.

Respectfully submitted,

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APPENDIX A

OPINION OF THE APPELLATE COURT OF ILLINOIS

BEN POLIKOFF,
Plaintiff-Appellant,

vs.

MAURICE S. LEVY, LOUIS C. RAPPAPORT, HARRY MILLER and SIDNEY MILLER,
Defendants-Appellees.

Appeal from the Circuit Court of Cook County, Illinois.

MR. PRESIDING JUSTICE BURMAN DELIVERED THE OPINION OF THE COURT.

This is an action to recover the sum of $57,500 which the plaintiff gave to the defendants in connection with the purchase of real estate in Springfield, Illinois, and the building of a motel thereon. The amended complaint contains four counts. Counts I and II are based on the common law and Counts III and IV are based on the Illinois Securities Law of 1953 and on the Federal Securities Act of 1933 respectively. The defendants' motion to dismiss the amended complaint was denied as to Counts I and II, which are therefore still pending in the trial court; the motion was granted as to Counts III and IV, and since the trial court made an express finding that there was no just reason for delaying appeal and since plaintiff chose to stand on the counts as pleaded, he has appealed to this court.

The complaint shows that one of the defendants, Maurice S. Levy, wrote to the plaintiff on November 25, 1959, to inform him that a group of persons limited to friends and relatives were going into a new venture. He wrote "we have

purchased a parcel of real estate in Springfield, Illinois, and are contemplating building a Super De Luxe Motel which the city is in dire need of. We are selling units of $10,000 each and we still have available for investment about 15 units or $150,000." Enclosed with the letter was an architect's sketch of the proposed motel and a detailed statement of the capital requirements and the financing of the total required capital of $665,000 as well as a projected account of room rentals and cost of operations.

The plaintiff agreed to invest $50,000 and sent a check for half that amount to Levy on December 7, 1959, in return for which Levy sent the plaintiff what he (Levy) described as a "tentative receipt until the actual agreements and other documents are prepared and delivered to you." The document acknowledged receipt of the check "for the purpose of acquiring an interest in the contemplated motel [referred to in the caption as 'State House Motor Motel'] in Springfield, Illinois." Thereafter, at Levy's request, the plaintiff mailed to Levy the balance of the $25,000 in return for which the plaintiff received a second "tentative receipt" acknowledging the sum as "the balance due for the purpose of acquiring a $50,000 interest in the contemplated building" of the motel. Subsequently, and again at Levy's request, the plaintiff sent Levy a check for $7,500.00 which Levy's letter acknowledged as the plaintiff's proportionate share of the purchase price of a vacant lot which would be included in the motel project. This letter was also described as a "tentative trust receipt until the documents are available for signature."

About February 3, 1962, the defendants organized a corporation and proposed to the plaintiff that he enter into a contract whereby he would agree to accept stock in the corporation. The plaintiff declared the contract unacceptable and has refused to enter into it.

The plaintiff contends that the sale of "units" as evidenced by the November 25th letter and the three receipts constituted the sale of a security within the meaning of the Illinois Securities Law of 1953 and of the Federal Securities Act of 1933 and that since the sale has not been registered with the appropriate state and federal agencies, plaintiff is entitled to avoid the sale and recover the payments he has made. The defendant contends that the plaintiff entered into a joint venture with the defendant and others to construct a motel and conduct a motel business and that such a sale is not subject to the state and federal securities laws.

Under both state and federal securities laws, the securities which fall within the scope of those acts must be registered with the appropriate agencies. (Ill. Rev. Stat. 1963, ch. 121½, §137.5 and 15 U.S.C.A. §77f.) The sale of unregistered securities is unlawful under both acts (Ill. Rev. Stat. 1963, ch. 121½, §137.12 and 15 U.S.C.A. §77e) and any person who purchases such securities may maintain an action under both acts to recover the consideration paid for such security (Ill. Rev. Stat. 1963, ch. 121½, §137.13 and 15 U.S.C.A. §771).

The sole question for us is whether the "units" of interest in the motel venture are securities as defined by the state and federal acts. The definition of "security" in both acts is identical in all respects relevent [*sic*] to the case at bar. The acts define "security" as:

> . . . any note, stock, . . . evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, . . . preorganization certificate or subscription, transferrable share, investment contract, . . . or, in general, any interest or instrument commonly known as a security, or any . . . certificate of interest or participation in, temporary or interim certificate for, re-

ceipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. (Ill. Rev. Stat. 1963, ch. 121½, §137.2-1 and 15 U.S.C.A. §77b(1)).

The courts have given the term "security" a broad construction and have held that the acts are paternalistic and hence are to be liberally construed to protect the public. In determining whether an instrument is a security within the meaning of the statute, the courts look to the substance of the transaction, to the relationship between the parties; these elements will control as against the form of the instrument. Form is disregarded for substance and emphasis is placed on economic reality. *Sire Plan Portfolios, Inc.* v. *Carpentier,* 8 Ill. App. 2d 354, 132 N.E. 2nd 78; *Meihsner* v. *Runyon,* 23 Ill. App. 2d 446, 163 N.E. 2d 236; *S.E.C.* v. *Howey Co.,* 328 U. S. 293; *S.E.C.* v. *Joiner Corp.,* 320 U.S. 344; *S.E.C.* v. *Universal Service Association,* 106 F.2d 232.

Both the Illinois and the federal courts have emphasized that a security within the meaning of the acts is a contract, transaction or scheme whereby one person invests his money in a common enterprise on the theory that he expects to receive profits *solely from the efforts of others. Sire Plan Portfolios, Inc.* v. *Carpentier,* 8 Ill. App. 2d 354, 132 N.E.2d 78; *S.E.C.* v. *Howey Co.,* 328 U.S. 293; *Hammer* v. *Sanders,* 8 Ill. 2d 414; 134 N.E.2d 509; *S.E.C.* v. *Bailey,* 41 F. Supp. 647. The reason for excluding from the scope of the securities laws those transactions in which the profits do not come solely from the efforts of others is clear. In such situations, the member of the enterprise pools his money with that of others in the group; he has an equal right of control over the project and the opportunity and right to know what is going on. Because of this, the protection of the full disclosure offered by registration is not needed as it is in cases involving a non-participating investor.

We believe that neither the Illinois Blue Sky Act nor the Federal Securities Act apply in the instant case. Here we have a joint venture to buy and improve real estate by a group which included the plaintiff and the defendants. A joint venture is an association of two or more persons to carry out a simple enterprise for profit. There must be a community of interest in the purpose for which the relation is established. *Ditis* v. *Ahlvin Const. Co.*, 408 Ill. 416, 97 N.E. 2d 244. There also must be an expectation of profit and the sharing thereof. *Sappenfield* v. *Mead*, 338 Ill. App. 236, 87 N.E.2d 220. These prerequisites for a joint venture have been met in the instant case. The complaint clearly shows a community of interest among the plaintiff and defendants to erect and operate a motel. The expectation of profit and the sharing thereof among the members of the group is equally clear. The fact that the formal agreements and documents described in the various receipts were never made or entered into by the plaintiff does not preclude a finding of a joint venture. Proof of the existence of this relationship may be made by evidence of the surrounding circumstances without evidence of any specific formal agreement. *Ditis* v. *Ahlvin Const. Co.*, 408 Ill. 416, 97 N.E. 2d 244. Moreover, the fact that the plaintiff did not know the identity of or formally approve the admission of members to the venture after he joined it, does not preclude the existence of a joint venture.

The relation of parties in a joint venture is so similar to that of partners that their rights and liabilities are generally tested by the same rules. *Ditis* v. *Ahlvin Const. Co.*, 408 Ill. 416, 97 N.E.2d 244. The general rule that new members of a partnership, and hence of a joint venture, must be known to and approved by the existing members of the group is subject to the agreement on which the relationship is based. Ill. Rev. Stat. 1963, ch. 106½, §18(g). In the in-

stant case, it was clear from the communications between Levy and the plantiff that the members of the group were not specifically identified for the plaintiff and the size of the group was not fixed at the time the plaintiff joined. We take it that the plaintiff joined with this knowledge, which in effect became a part of the informal agreement on which the venture was based.

In both partnerships and in joint ventures members of the group have equal rights of management and control of the enterprise. *Lindley* v. *Murphy*, 387 Ill. 506, 56 N.E.2d 832. Hence when the plaintiff paid his money into the motel project as a member of a joint venture, he acquired equal rights of control of the activities of the venture. Therefore we believe that he did not pay his money with the expectation that future profits from the venture would come *solely from the efforts of others.* Hence the transactions involved here do not fall within the scope of the Illinois or federal securities acts.

The plaintiff cites two cases to show that "units" are "securities" within the provisions of the acts on which he relies. In *Freeze* v. *Smith*, 254 Mich. 386, 236 N.W. 810, a syndicate was formed for the purpose of purchasing certain real estate for subdivision and sale. Forty-two "units" were sold and the court held that plaintiff did not acquire an undivided interest in land and the "units" he purchased were under that Blue Sky Act. By contrast, in the case at bar the plaintiff chose to associate himself with others in a joint venture to construct a single project and acquired a direct, undivided interest in the motel operation. In *State* v. *Golden*, 216 Minn. 97, 12 N.W. 2d 617, the court explicitly decides that what was involved there was not a joint venture, but a mere sale of an interest in oil lands which was within the scope of that state's Blue Sky Act. We have examined all of the cases cited by the plaintiff and do not find

that they are applicable under the pleadings in the case at bar or support the plaintiff's theory. We see no useful purpose in a discussion of those cases.

It is quite clear that a joint venture to buy real estate and construct and operate a motel and to share in the profits is not within the provisions of either the Illinois Blue Sky Act or the Federal Securities Act. The judgment of the trial court in dismissing Counts III and IV is therefore affirmed.

AFFIRMED.

MURPHY and KLUCZYNSKI, JJ., concur.

APPENDIX B

JUDGMENT OF THE APPELLATE COURT OF ILLINOIS

BEN POLIKOFF,
Appellant,

No. 49459 vs.

MAURICE S. LEVY, LOUIS C. RAPPAPORT, HARRY MILLER and SIDNEY MILLER,
Appellees.

Appeal from the Circuit Court of Cook County

AFFIRMING ORDER

The judgment of the Circuit Court of Cook County is AFFIRMED and Appellees recover costs from Appellant.

Execution may issue.

APPENDIX C

COUNT IV OF THE AMENDED COMPLAINT*

*1. On or about November 25, 1959 defendant, Maurice S. Levy, sent to plaintiff a letter, a copy of which is as follows:

Maurice S. Levy
Attorney and Counsellor
1757 First National Bank Building
33 South Clark Street
Chicago 3
Telephone CEntral 6-3053

November 25, 1959

Mr. Ben Polikoff
1010 Seward Street
Evanston, Illinois

Dear Ben:

I had hoped to talk to you when I saw you at the theatre. I am writing you and giving you some information that may be of some interest to you.

As you know a group consisting of my brothers-in-law, Al Wolf and others have interests in several parcels of real estate in Chicago, and we are going into a new venture. We have purchased a parcel of real estate in Springfield, Illinois, and are contemplating building a Super DeLuxe Motel which the city is in dire need of. We are selling units of $10,000.00 each and we still have available for investment about 15 units or $150,000.00.

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* The paragraphs preceded by an asterisk were incorporated by reference in Count IV of the amended complaint and are set forth in full in this Appendix C.

I am enclosing a statement and also a picture of the motel which is going to be built by Newhouse & Newhouse, architects, and we are waiting for a commitment of a mortgage which should come through any day.

If you are interested please let me know as I am desirous of procuring people in this picture who we know and not go outside of our friends.

My kindest regards to Mae and your little family, I remain

Sincerely,

MSL:CM Maurice S. Levy

Together with said letter, he also sent to plaintiff a "statement", referred to in said letter, a copy of which is as follows:

Prepared November 18, 1959

STATE HOUSE MOTEL
Springfield, Illinois

COMPUTATION OF CAPITAL REQUIREMENTS

Property Cost:		
Land	$ 250,000	
Building	1,000,000	
Architectural, Structural, Mechanical and Engineering Fees	60,000	
		$1,310,000
Furnishings—Approximately $1,000 per room		150,000
Interim Financing, Mortgage Commission, Title Costs, Taxes, Insurance, Legal and Sundry Expenses		100,000
Total Costs		$1,560,000
Less—Financing:		
Real Estate Mortgage	850,000	
Furnishings Contract	75,000	
		925,000
Balance Required		$ 635,000
Working Cash (approximately 2 months operating expenses)		30,000
TOTAL CAPITAL REQUIRED		$ 665,000

Prepared November 18, 1959

STATE HOUSE MOTEL
Springfield, Illinois

PROJECTED ANNUAL CASH FLOW
BASED ON ESTIMATED 72% OCCUPANCY

Receipts:			
Room Rentals (156 Rooms at $11.00 per day, 72% Occupancy or 40,989 room days Equals (450,884)		$ 450,000	
Restaurant and Bar Minimum Rental		25,000	
			$ 475,000
Disbursements:			
Operating Payroll:			
1 Manager	$10,000		
1 Assistant Manager	6,500		
4 Room Clerks	15,000		
1 Secretary	3,500		
4 Bell Boys	5,000		
7 Maids	18,000		
1 Housekeeper	5,000		
1 Bookkeeper	5,000		
3 Telephone Operators (2 Regular and 1 Relief)	8,000		
3 Engineer, Maintenance and Houseman	15,000		
		$ 91,000	
Operating Expenses:			
Payroll Taxes	5,000		
Laundry	17,500		
Room and Housekeeping Supplies	10,000		
Replacements, Repairs and Maintenance	15,000		
Electricity	12,000		
Electric Bulbs	1,000		
Oil or Gas	5,000		
Outdoor and Local Advertising	10,000		
Stationery, Printing and Magazines	3,000		
Water	2,000		
Scavenger	1,000		
Administrative Costs, Professional Fees, etc.	10,000		
Real Estate Taxes	25,000		
Insurance	6,500	123,000	
			$214,000

Cash Available for Debt Service, Contingencies, etc. ...		$261,000
Less—Real Estate Mortgage Payments (including interest on $850,000 loan at 6½%—15 year level payment	89,000	
Furnishings payments	28,000	
Provision for Contingencies	14,000	
		131,000
CASH THROWOFF		$130,000

Note: Projected receipts above are exclusive of rentals from public meeting rooms or percentage rentals from restaurant and bar, if any.

Together with said letter, he also sent to plaintiff a sketch described in said letter as "a picture of the motel which is going to be built by Newhouse and Newhouse, architects."

*2. In sending said letter, "statement," and "picture" to plaintiff and, in the transactions hereinafter stated, defendant, Maurice S. Levy, was acting in his own behalf and in behalf of the defendants, Louis C. Rappaport, Harry Miller and Sidney Miller. The defendants were promoting or, as stated in said letter, "going into" a motel enterprise to be conducted on the parcel of real estate referred to in said letter, and, to that end, they had, prior to the date of said letter, "purchased" said parcel of real estate, each of the defendants providing part of the earnest money and other payments made on account of the purchase price thereof. They had engaged Newhouse and Newhouse, a firm of architects, to perform architectural services in connection with the building of a motel upon said parcel of real estate. They had made efforts to obtain a mortgage loan or a commitment therefor, and, as stated in said letter, they were "waiting for a commitment of a mortgage which should come through any day." They had solicited people to give money for the enterprise.

*3. On and after November 25, 1959, the defendants continued to solicit people, including plaintiff, to give money for the enterprise and they offered and attempted to sell so-called "units." In the letter sent to plaintiff, a copy of which is set forth above, it was stated "We are selling units of $10,000 each and we still have available for investment about 15 units or $150,000.00." The purpose of sending said letter was to induce plaintiff to invest money in said enterprise. As a result of such soliciting and of the offers to sell and attempts to sell so-called "units", defendants were given, from time to time, both before November 25, 1959 and during a period of more than a year after November 25, 1959, approximately $500,000.00 by forty or more people.

*4. After receiving said letter, "statement" and "picture", plaintiff informed defendant, Maurice S. Levy, that he would be willing to make an investment of $50,000.00; and, on or about December 7, 1959, at the request of defendant, Maurice S. Levy, plaintiff sent him $25,000.00.

*5. Defendant, Maurice S. Levy, sent plaintiff a receipt for said $25,000.00, therein called a "tentative receipt", a copy of which is as follows:

Maurice S. Levy
Attorney and Counsellor
1757 First National Bank Building
33 South Clark Street
Chicago 3
Telephone CEntral 6-3053

December 7, 1959

Mr. Ben Polikoff
c/o Polymold Plastics, Inc.
3417 North Western Avenue
Chicago 18, Illinois

Re: State House Motor Motel

Dear Ben:

This will acknowledge receipt of your check for $25,000.00 for the purpose of acquiring an interest in the contemplated building at the above motel in Springfield, Illinois. This represents one-half of your proposed commitment which was made to me.

This letter is in the form of a tentative receipt until the actual agreements and other documents are prepared and delivered to you.

With kindest regards, I remain

MSL:CM

Sincerely,
Maurice S. Levy

A certificate representing so-called "units", mentioned in the letter dated November 25, 1959, was not given or sent to plaintiff for the $25,000.00 so sent to defendant, Maurice S. Levy, at his request, but only the receipt above set forth.

*6. Thereafter and prior to February 2, 1960, defendant, Maurice S. Levy, requested plaintiff to send to him another

$25,000.00, and plaintiff sent to defendant, Maurice S. Levy, a second $25,000.00.

*7. Defendant, Maurice S. Levy, sent plaintiff a receipt for said second $25,000.00, therein also called a "tentative receipt", a copy of which is as follows:

Maurice S. Levy
Attorney and Counsellor
1757 First National Bank Building
33 South Clark Street
Chicago 3

Telephone CEntral 6-3053

February 2, 1960

Mr. Ben Polikoff
1010 Seward Street
Evanston, Illinois

Re: State House Motor Motel

Dear Ben:

This will acknowledge receipt of your check for $25,000.00 which represents the balance due for the purpose of acquiring a $50,000.00 interest in the contemplated building of the above motel in Springfield, Illinois.

This letter is in the form of a tentative trust receipt until the actual agreements and other documents are delivered to you.

With kindest regards, I remain

Sincerely,
Maurice
Maurice S. Levy

MSL/rk

A certificate representing so-called "units", mentioned in the letter dated November 25, 1959, was not given or sent

to plaintiff for the second $25,000.00 so sent to defendant, Maurice S. Levy, at his request, but only the receipt above set forth.

*8. Thereafter, and prior to December 7, 1960, plaintiff, at the request of defendant, Maurice S. Levy, sent to defendant, Maurice S. Levy, an additional $7,500.00.

*9. Defendant, Maurice S. Levy, sent plaintiff a receipt for said $7,500.00, therein also called a "tentative receipt," a copy of which is as follows:

Maurice C. Levy
Attorney and Counsellor
1757 First National Bank Building
33 South Clark Street
Chicago 3
Telephone CEntral 6-3053

December 7, 1960

Mr. Ben Polikoff
1010 Seward Street
Evanston, Illinois

Re: State House Motor Motel

Dear Ben:

This will acknowledge receipt of your check in the sum of $7500.00 representing your proportionate share of the monies necessary for the purchase of the vacant lot, which will be included in our motel project.

This letter is sent to you in the form of a tentative trust receipt until the documents are available for signature.

With kindest regards, I am

Sincerely,
Maurice
Maurice S. Levy

MSL:rk

A certificate for so-called "units" mentioned in the letter dated November 25, 1959 was not given or sent to plaintiff for said $7,500.00 so sent to defendant, Maurice S. Levy, at his request, but only the receipt above set forth.

10. Defendants, through the medium of said letter dated November 25, 1959 and the "statement" and "picture" sent with it, offered to sell to plaintiff so-called "units of $10,000.00 each" mentioned in said letter. After being informed by plaintiff that he would be willing to make an investment of $50,000.00, they asked plaintiff, first for $25,000.00; then, for a second $25,000.00; and then, for an additional $7,500.00. Plaintiff gave defendants the amounts of money so requested, and defendants, upon receiving the same, delivered to plaintiff a "tentative" receipt for each amount, respectively, copies of which "tentative" receipts are set forth in paragraphs 5, 7 and 9 hereof.

*11. Thereafter, about February 3, 1962, defendants caused a corporation named The State House Inn Corp. to be organized under the laws of the State of Illinois, and they then offered and attempted to sell and dispose of stock in said corporation to plaintiff. They proposed to plaintiff that he agree to accept, and accept, stock in said corporation for the $57,500.00 he had given to them as above stated and for all rights and interests which plaintiff had by virtue of the giving of the $57,500.00. The agreement they proposed and the terms and provisions they proposed to include therein were not acceptable to plaintiff, and he was not willing to, and refused to, enter into it. But, nevertheless, the defendants, purporting to act in behalf of plaintiff, made such an agreement and they thereby transferred, or purported to transfer, to said corporation all the rights which plaintiff had by virtue of the giving of the $57,500.00, and they also transferred to said corporation the motel and all rights and interests with respect thereto; and, notwith-

standing they transferred or purported to transfer plaintiff's rights and interests, they did not repay or offer to repay plaintiff the $57,500.00 he had given. As a result of the agreement and transactions made to carry it into effect, the corporation has the motel, and plaintiff, for the $57,500.00 he gave, has receipts. By so purporting to make such an agreement in behalf of plaintiff, the defendants attempted to bind plaintiff to take stock in said corporation for the $57,500.00 given as above stated. The agreement and the other instruments and writings which defendants made in connection with the transfer of plaintiff's rights and interests and in connection with the transfer of the motel and all rights and interests with respect thereto to said corporation, and in connection with said corporation and the stock issued or proposed to be issued are in the possession or control of the defendants and are within their knowledge rather than plaintiff's.

12. Such "units of $10,000.00 each", and said receipts for the $57,500.00 delivered to plaintiff as aforesaid, and the stock in The State House Inn Corp. were, and are, securities as defined in the Act of Congress known as the Securities Act of 1933. None was, or is, an exempted security under said Act, nor were the transactions in connection therewith, as stated above, exempted transactions under said Act.

13. The defendants made use of the mails in so offering to sell such so-called "units of $10,000.00 each" to plaintiff through the medium of said letter and the "statement" and "picture" sent with it. They caused the same to be mailed to plaintiff. They also caused said receipts to be carried through the mails in order to deliver them to plaintiff. They also made use of the mails in connection with the offer and attempt to sell and dispose of stock in said corporation to plaintiff.

14. No registration statement as provided in said Securities Act of 1933 was ever in effect with respect to the so-called "units of $10,000.00 each", with respect to such receipts, or with respect to the stock in said corporation. No registration statement and no prospectus whatsoever were ever filed with the Securities and Exchange Commission as provided in the Securities Act of 1933 with respect to the so-called "units of $10,000.00 each" mentioned in such letter, with respect to said receipts, or with respect to the stock in said corporation.

15. On July 19, 1962 plaintiff sent to each of the defendants by registered mail a notice and demand, copy of which is attached to this complaint as Exhibit 1 and made a part of this Count IV.

*16. Plaintiff has heretofore tendered to the defendants the securities sold, including said instruments or receipts given him for the money given them; and he also tendered and offered to give the defendants an assignment, quitclaim deed, disclaimer and such other instruments sufficient to effect the relinquishment of any interest in said motel (or hotel) and in all appurtenances thereto, and in all furniture and equipment therein, and in the parking lot or in the so-called vacant lot, which they may suppose he has by virtue of such transactions or otherwise; and he has demanded the repayment of the $57,500.00 given as above set forth; and plaintiff now brings into court and tenders to the defendant said securities and interests. By reason of the matters above set forth, the sales of said securities and so-called "units of $10,000.00 each", and the offers and attempts to sell and dispose of the same and the stock in said corporation were and are void, and plaintiff has heretofore elected, and does now elect, to declare said sales of said securities to him and said transactions null and void.

17. By virtue of the Securities Act of 1933 the plaintiff is entitled to recover from defendants the sum of $57,500.00 and interest thereon.

Wherefore plaintiff asks judgment against the defendants and each of them in the sum of $57,500.00 and interest and his costs.

/s/ Tannenbaum & Polikoff
Tannenbaum & Polikoff
Attorneys for plaintiff
111 West Washington Street
Chicago 2, Illinois
FRanklin 2-0111

State of Illinois }
County of Cook } ss:

Ben Polikoff, being first duly sworn, on oath deposes and says that he is the plaintiff in the above entitled cause, that he has read the above and foregoing amended complaint and knows the contents thereof; and that the statements therein contained are true to his own personal knowledge.

/s/ Ben Polikoff

Subscribed and sworn to before me this 27th day of March, 1963.

(Seal) /s/ Robert I. Polikoff
Notary Public

EXHIBIT 1

July 19, 1962

TO: Maurice S. Levy, 33 South Clark Street, Chicago 3, Illinois; Louis C. Rappaport, 134 North LaSalle Street, Chicago 2, Illinois; Harry Miller, 2601 West Fitch Avenue, Chicago 45, Illinois; Sidney Miller, 2629 West Fifth Avenue, Chicago 45, Illinois.

Demand For Repayment Of $57,500.00 And Notice And Tender Pursuant To The Illinois Securities Law Of 1953, As Amended.

I hereby demand that you repay me the $57,500.00 I gave you as per three receipts bearing dates and for the amounts as follows: December 7, 1959, $25,000.00; February 2, 1960, $25,000.00; December 7, 1960, $7,500.00.

Notice is given that the transactions in which I gave you said $57,500.00 are voidable, and abrogated, annulled and at an end.

Said transactions related to a motel in Springfield, Illinois, which is referred to, in the first of said receipts, as "State House Motor Motel" and, in the second and third receipts, as "State House Motor Hotel".

I hereby tender to you the "securities sold" (as defined in The Illinois Securities Law of 1953, as amended), including said receipts given me for the money I gave you; and I also tender and offer to give you an assignment, quit claim deed, disclaimer, and such other instruments sufficient to effect the relinquishment of any interest in said motel (or hotel) and in all appurtenances thereto, and in all furniture and equipment therein, and in the parking lot or so-called "vacant lot," which you may suppose I have by virtue of such transactions, or otherwise.

Ben Polikoff